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No. 92

In the Supreme Court of the United States

OCTOBER TERM, 1928

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

NORTH TEXAS LUMBER COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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PETITION

The Attorney General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit, entered in the above cause on February 15, 1929, reversing the decision of the United States Board of Tax Appeals.

STATEMENT

The taxpayer on December 27, 1916, granted a ten-day option to the Southern Pine Lumber Company to purchase its timber lands for a certain

price. (R. 23–26.) The title to the property was examined on the same day and found to be satisfactory to the buyer. (R. 26.) On December 29, 1916, the Southern Pine Lumber Company arranged for a loan from a bank and telegraphed the taxpayer that it would exercise the option and would pay over the money as soon as the papers were prepared. Taxpayer thereupon ceased its operations on the property and withdrew its men who were working on the property. The written instruments which were required to complete the transfer were delivered on January 5, 1917, and the purchase price paid on that date. (R. 27.) The taxpayer company liquidated its business in 1917 subsequent to disposal of the timber land. (R. 23.)

The Southern Pine Lumber Company was amply solvent, ready and willing to carry out the contract of sale. (R. 27.)

The taxpayer kept its books upon an accrual basis. (R. 23.)

The Board of Tax Appeals affirmed the Commissioner's determination that the taxpayer realized a profit from the sale of its lands in 1917 which was held to be taxable as income for that year. (R. 28–30.) This decision was reversed by the Circuit Court of Appeals for the Fifth Circuit. (R. 56.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In reversing the decision of the Board of Tax Appeals.

2. In holding that the profits from the sale of taxpayer's lands accrued to it when the contract to sell was entered into and not when the sale was consummated.

REASONS FOR GRANTING THE WRIT

The case is of general importance and the question is one which is constantly arising.

It has long been the consistent practice of the Bureau of Internal Revenue to hold that profits from sales accrue and become taxable only when the sales are consummated. The decision in this case of the Circuit Court of Appeals, that there is an accrual of profits with the execution of an enforceable contract, is therefore contrary to the long continued practice of the Bureau and leaves in doubt the treatment of the question in the future disposition of cases.

Cases are constantly arising involving this question and should the rule laid down by the Circuit Court of Appeals in the instant case be not adopted in other circuits serious loss of revenue to the Government might result if the assessments in such cases had been made to conform to this decision. This consequence would flow from the fact that under the recent Revenue Acts the period within which assessments may be made has been greatly shortened. So, should it be held by another Circuit Court of Appeals that taxable profits had been treated as arising in the wrong year, when assessed in accordance with the rule of this case, it is likely

that the statutory period within which a new assessment might be made would have already expired.

While the instant case is so far the only decision of an appellate court passing directly upon the question of when profits accrue from a sale, yet the reasoning of the Circuit Court of Appeals for the Second Circuit in the case of *Bedell* v. *Commissioner*, 30 F. (2d) 622, affords basis for apprehending a possible conflict of decision in the matter, if that case be not itself regarded as conflicting authority.

The decision of the court below, if acquiesced in, would leave the subject in confusion.

Wherefore, it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals for the Fifth Circuit should be granted.

WILLIAM D. MITCHELL,
Attorney General.

MAY, 1929.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 28–30) is reported in 7 B. T. A. 1193. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 55), reversing the decision of the Board, is reported at 30 F. (2d) 680.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Fifth Circuit was entered on February 15,

1929. (R. 55.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. The appeal to the Board of Tax Appeals was taken prior to the passage of the Revenue Act of 1926, and there is presented the question whether the statutes authorizing appeals from the Board of Tax Appeals to the Circuit Courts of Appeals are unconstitutional on the ground that no judicial case or controversy is presented. This question is involved in No. 130, *Old Colony Trust Company* v. *Commissioner of Internal Revenue*, argued on April 15, 1929.

QUESTION PRESENTED

Did profits derived from the sale of respondent's lands accrue as income to the respondent in the year 1916 when the contract to sell was entered into, or in the year 1917 when conveyance was perfected?

STATUTES INVOLVED

The pertinent parts of the Revenue Acts of 1916 and 1917 are as follows:

Act of October 3, 1917, c. 63, 40 Stat. 300, 329:

> SEC. 1200. That subdivision (a) of section 2 of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:
>
> "(a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income, derived from salaries, wages, or compensation

for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

Act of September 8, 1916, c. 463, 39 Stat. 756, 770:

SEC. 13. (d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

STATEMENT

A statement of the facts and of the errors relied upon will be found in the petition.

ARGUMENT

The taxpayer in the instant case did not keep its accounts upon the basis of actual receipts and disbursements, but its books were kept upon an ac-

crual basis. In accordance with the provisions of Section 13 (d) of the Revenue Act of 1916, the taxpayer was entitled to report its income upon the basis upon which its books were kept if such basis clearly reflected its income. But even an accrual system of accounting may not properly treat as income the profits from a sale which has not been completed. Especially is this true where the sale effects a total disposition of taxpayer's assets, or, in other words, a liquidation of its business. In such a case the situation is quite different from ordinary merchandising transactions, and in accordance with the principles of good accounting liquidating sales should be reported only in the year when finally completed, if income is properly to be reflected.

It has not been contested in the instant case that the taxpayer and the buyer had entered into a binding contract to sell the property in question. Nevertheless it is urged that the taxpayer, not having the unconditional right to the purchase price during the year 1916, may not include the profits from the sale in its income for that year, and that the profits should be included in income for the year 1917 when the sale was completed.

Under the "accrual" method of accounting, as opposed to the "actual receipts and disbursements" method, there is reported as income the income accrued and the expenses accrued whether actually received or not.

With respect to Federal taxation the courts have not attempted a precise definition of the term "accrued," but they have uniformly stressed the rule that income does not accrue until all the events conditional to payment have occurred and the liability has become fixed. *Edwards* v. *Keith*, 231 Fed. 110, 112 (certiorari denied, 243 U. S. 638); *Consolidated Tea Co.* v. *Bowers*, 19 F. (2d) 382; *United States* v. *Anderson, United States* v. *Yale & Towne Mfg. Co.*, 269 U. S. 422. This definition of the term "accrued" has also been applied in *Allen* v. *Armstrong*, 68 N. Y. S. 1079, and in *Ed. Schuster & Co.* v. *Williams*, 283 Fed. 115. See also Holmes Federal Taxes (6th Ed.), p. 1248.

This Court in the *Yale & Towne case, supra*, held that munitions taxes imposed by the United States accrued in the year the profits were earned, although the taxes were paid in subsequent years. The principle that to constitute an accrual all the events conditional to liability must have occurred was clearly recognized.

From the foregoing it is apparent that if the right to payment is not fixed but is conditional, income can not be said to have accrued.

In the instant case the taxpayer had neither made nor tendered conveyance in 1916. In fact, time was required to prepare the deed and this preparation was not completed until 1917.

The covenants of the vendor to convey and the covenants of the vendee to pay the purchase money

were mutual, reciprocal, and dependent. The contract in the instant case merely provided for the payment of the purchase price on the one hand and the conveyance of the property on the other, and no time was fixed for either and nothing was specified as to the relation of the two acts. (R. 4–6.) Under such state of facts the right to the purchase price was conditional. Before the taxpayer could be unconditionally entitled to the purchase price, which would include its profits, it would have to make a conveyance or tender of conveyance. *Montgomery* v. *Wise,* 138 Mo. App. 176; *Gober* v. *Hart,* 36 Tex. 139; *Clifton* v. *Charles,* 53 Tex. Civ. App. 448. The duty was also upon the taxpayer to prepare the conveyance, which was not done in the year 1916. *Perry* v. *Rice,* 10 Tex. 367.

In the case of *Bedell* v. *Commissioner of Internal Revenue,* 30 F. (2d) 622, the Circuit Court of Appeals for the Second Circuit held that the gain from a transaction involving the purchase and sale of a building is income in the year in which title passed and not in the year the contract of sale was made. In its opinion the court stated as follows (p. 624):

> While equity regards a vendee before payment as owner, still the payment is for the title, and is conditional on its delivery, as much as in the case of chattels where title has not passed. Of course, it is true that an obligation, even a conditional obligation, is

> in some sense property, and like anything else that can be transferred, may be said to have a value, but nevertheless payment is made in exchange for title, and will never be made if it is not conveyed. To speak of the profit as resulting because its amount can be presently ascertained, though performance remains uncertain, seems to us a perversion of language.

The foregoing decision, while dealing with a case where the taxpayer was on a cash receipts and disbursements basis, made no distinction between the various methods of accounting, and the reasoning of the opinion is susceptible of general application, irrespective of the method of accounting.

No profit is derived from a mere contract to sell. The sale may never be consummated; the parties may agree to rescind the contract, or they may both become unable to perform. Income is only derived from completed and closed transactions. A contract to sell becomes a completed and closed transaction when the sale is consummated. At that time income may be realized, but not before. Certainly, it can not be said that one realizes a profit from an agreement to sell.

CONCLUSION

In view of the far-reaching effect of the opinion below and the manifest need for an authoritative rule for the guidance of the Treasury Department in administering the tax statutes, it is respectfully

submitted that the petition for a writ of certiorari should be granted.

WILLIAM D. MITCHELL,
Attorney General.
MABEL WALKER WILLEBRANDT,
Assistant Attorney General.
ALFRED A. WHEAT,
RANDOLPH C. SHAW,
Special Assistants to the Attorney General.

MAY, 1929.

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